

STATEMENT OF  
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before the

SUBCOMMITTEE ON COMPENSATION  
AND EMPLOYEE BENEFITS  
COMMITTEE ON POST OFFICE AND CIVIL SERVICE  
U.S. HOUSE OF REPRESENTATIVES

on

FISCAL YEAR 1984 BUDGET PROPOSALS  
CONCERNING CIVIL SERVICE RETIREMENT  
AND FEDERAL EMPLOYEES HEALTH BENEFITS

FEBRUARY 16, 1983

MADAM CHAIR AND MEMBERS OF THE SUBCOMMITTEE:

THANK YOU FOR INVITING ME TO APPEAR THIS MORNING TO DISCUSS THE ADMINISTRATION'S FISCAL YEAR 1984 BUDGET PROPOSALS ON CIVIL SERVICE RETIREMENT AND THE FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM. ACCOMPANYING ME TODAY IS MR. JAMES W. MORRISON, JR., OPM'S ASSOCIATE DIRECTOR FOR COMPENSATION.

CIVIL SERVICE RETIREMENT

IN THE MORE THAN 60 YEARS THE CIVIL SERVICE RETIREMENT SYSTEM HAS BEEN IN EXISTENCE, IT HAS SERVED WELL ITS PURPOSE OF PROVIDING FINANCIAL SECURITY FOR FEDERAL RETIREES AND SURVIVORS, BUT IT HAS DONE SO AT A TREMENDOUS COST. TODAY THIS SYSTEM HAS A HALF TRILLION DOLLAR DEBT (UNFUNDED LIABILITY), WHICH THREATENS ITS INTEGRITY. THE SUCCESS WHICH THE SYSTEM HAS ACHIEVED HAS BEEN ACCOMPLISHED IN RECENT YEARS ONLY AT EVER-INCREASING COST TO THE TAXPAYER. WHILE EMPLOYEES DO CONTRIBUTE TO THE SYSTEM, GENERALLY 7 PERCENT OF PAY, THESE CONTRIBUTIONS PAY FOR LESS THAN 20 PERCENT OF THE VALUE OF THE BENEFITS THAT WILL BE RECEIVED. THE BALANCE MUST COME FROM THE GOVERNMENT. COSTS TO THE GOVERNMENT INCREASED BY 2,351 PERCENT BETWEEN 1960 AND 1981, AND WE CAN NO LONGER REASONABLY EXPECT THE TAXPAYERS WILL IGNORE THIS

GENEROSITY. THIS IS PARTICULARLY TRUE IN VIEW OF THE FACT THAT THE BENEFITS UNDER THIS SYSTEM ARE MORE GENEROUS AND THE RETIREMENT AGE SO MUCH EARLIER THAN FOR THE VAST MAJORITY OF AMERICANS.

IN ORDER TO MAKE THE SYSTEM SOLVENT IN THE LONG RUN, TO HAVE IT EQUALLY SUPPORTED BY EMPLOYEE AND EMPLOYER AS WAS PLANNED, TO BRING THE COSTS OF THE RETIREMENT SYSTEM MORE INTO LINE WITH WHAT THE GOVERNMENT CAN AFFORD, AND TO MAKE THE BENEFITS MORE COMPARABLE WITH WHAT NON-FEDERAL RETIREES RECEIVE, WE ARE PROPOSING SEVERAL REFORMS.

FIRST, WE PROPOSE THAT CURRENT FEDERAL EMPLOYEES WITH SUFFICIENT SERVICE CONTINUE TO BE ABLE TO RETIRE AS EARLY AS AGE 55, BUT BENEFITS WOULD BE REDUCED TO REFLECT THE COST TO THE RETIREMENT SYSTEM OF THIS EARLY RETIREMENT. FOR EACH YEAR THE EMPLOYEE IS UNDER AGE 65 AT THE TIME OF RETIREMENT, THE ANNUITY WOULD BE REDUCED BY 5 PERCENT. THIS REDUCTION WOULD NOT APPLY TO ANYONE WHO IS ALREADY 55, AND IN ORDER TO EASE ITS IMPACT ON THOSE NEAR RETIREMENT, THE REDUCTION WOULD BE PHASED IN OVER 10 YEARS. FOR INSTANCE, AN EMPLOYEE WHO IS NOW 54 COULD RETIRE AT 55 WITH AN ANNUITY REDUCTION OF ONLY 5 PERCENT. ONLY THOSE NOW 45 AND UNDER WOULD BE SUBJECT TO THE FULL REDUCTION.

SECOND, WE PROPOSE CERTAIN CHANGES IN COST-OF-LIVING ADJUSTMENTS FOR FEDERAL RETIREES. BASED ON THE RECOMMENDATIONS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM, THE BUDGET PROPOSES THAT COST-OF-LIVING ADJUSTMENTS FOR SOCIAL SECURITY BE DELAYED FOR SIX MONTHS, AND THE SAME SIX-MONTH DELAY WILL BE APPLIED TO CERTAIN OTHER INDEXED PROGRAMS, NAMELY SUPPLEMENTARY SECURITY INCOME, RAILROAD RETIREMENT, VETERANS' PENSIONS AND COMPENSATION, AND FOOD

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STAMPS AND CHILD NUTRITION PROGRAMS. FOR CIVIL SERVICE ANNUITANTS, OTHER FEDERAL CIVILIAN AND MILITARY RETIREES, AND RECIPIENTS OF FEDERAL WORKERS' DISABILITY COMPENSATION AND THE FISCAL YEAR 1984 ADJUSTMENT WOULD BE FROZEN FOR THE FULL YEAR. THE DIFFERENT TREATMENT WOULD BE IN RECOGNITION OF THE RELATIVELY LARGER BENEFITS BEING PAID UNDER THE GOVERNMENT PENSION PROGRAMS. THE FREEZE WOULD BE ONLY FOR ONE YEAR. IN 1985, COST-OF-LIVING ADJUSTMENTS UNDER THE CIVIL SERVICE RETIREMENT SYSTEM WOULD RETURN TO THE PROVISIONS OF THE 1982 RECONCILIATION ACT, AND IN SUBSEQUENT YEARS, WE WOULD CONTINUE THE PRINCIPLE ESTABLISHED BY THE RECONCILIATION ACT OF PAYING ONLY ONE-HALF OF THE NORMAL COST-OF-LIVING ADJUSTMENT TO NON-DISABILITY RETIREES UNDER AGE 62.

THIRD, WE PROPOSE RETURNING TO THE USE OF THE HIGH-FIVE-YEARS' AVERAGE SALARY, RATHER THAN THE HIGH-THREE-YEARS' AVERAGE, IN COMPUTING EMPLOYEE BENEFITS. THIS CHANGE WOULD NOT TAKE EFFECT FOR THREE YEARS, AND WOULD NOT AFFECT ANYONE WHO IS ELIGIBLE TO RETIRE BY THE EFFECTIVE DATE.

OUR OBJECTIVE IN MAKING THESE CHANGES IN BENEFITS IS TO REDUCE THE COSTS OF THE RETIREMENT SYSTEM FROM THE CURRENT 35 PERCENT OF PAYROLL TO APPROXIMATELY 22 PERCENT OF PAYROLL, WHICH WOULD BE CONSISTENT WITH THE COST OF PRIVATE SECTOR RETIREMENT BENEFITS, INCLUDING SOCIAL SECURITY. IF THE CHANGES OUTLINED ABOVE ARE NOT SUFFICIENT TO ACCOMPLISH THIS COST REDUCTION TO 22 PERCENT, WE ALSO PROPOSE TO IMPLEMENT A REDUCTION IN THE FORMULA USED TO COMPUTE INITIAL ANNUITIES.

FINALLY, WITH THE COSTS OF THE SYSTEM REDUCED TO 22 PERCENT OF PAYROLL, WE PROPOSE RETURNING TO THE PRINCIPLE THAT THE MATCHING CONTRIBUTIONS OF EMPLOYEES AND THEIR AGENCIES SHOULD BE SUFFICIENT TO FUND THE SYSTEM. IN

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ORDER TO MAKE THE SYSTEM SELF-SUPPORTING, THE CONTRIBUTION RATE WOULD BE INCREASED 2 PERCENT IN FISCAL YEAR 1984, AND A FURTHER 2 PERCENT IN FISCAL YEAR 1985. IN 1985, WITH EMPLOYEES AND AGENCIES GENERALLY CONTRIBUTING 11 PERCENT APIECE, THE FULL 22 PERCENT COST OF THE SYSTEM WILL BE PAID ON A CURRENT BASIS.

#### SOCIAL SECURITY SUPPLEMENTAL PLAN

UNDER THE BIPARTISAN RECOMMENDATIONS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM, FEDERAL EMPLOYEES HIRED AFTER JANUARY 1, 1984, WILL BE COVERED UNDER SOCIAL SECURITY RATHER THAN THE CIVIL SERVICE RETIREMENT SYSTEM. THERE HAS BEEN MUCH CONCERN EXPRESSED THAT SOCIAL SECURITY ALONE WILL NOT PROVIDE ADEQUATE RETIREMENT BENEFITS FOR THOSE NEW EMPLOYEES. HOWEVER, THE ADMINISTRATION WILL PROPOSE ESTABLISHING A NEW STAFF RETIREMENT PLAN TO SUPPLEMENT SOCIAL SECURITY COVERAGE. THE NEW PLAN WOULD GENERALLY PARALLEL THE REFORMED CIVIL SERVICE RETIREMENT SYSTEM, WITH, FOR EXAMPLE, RETIREMENT AS EARLY AS AGE 55, ALTHOUGH WITH AN ACTUARIAL REDUCTION FOR SUCH EARLY RETIREMENT. COST-OF-LIVING ADJUSTMENTS RELATED TO THE CONSUMER PRICE INDEX WOULD BE PROVIDED.

AGENCIES AND THEIR EMPLOYEES COVERED UNDER SOCIAL SECURITY AND THIS NEW STAFF PLAN WOULD EACH CONTRIBUTE 11 PERCENT OF SALARY FOR SUCH COMBINED COVERAGE, WITH THIS CONTRIBUTION GOING FIRST TO PAY THE OASDI TAX FOR SOCIAL SECURITY, AND THE BALANCE GOING TO THE STAFF PLAN. AGENCIES WOULD BE REQUIRED TO PAY A MATCHING AMOUNT. THIS NEW PLAN, WHEN COMBINED WITH SOCIAL SECURITY BENEFITS, WILL PROVIDE THE SORT OF COMPREHENSIVE RETIREMENT SECURITY THAT FEDERAL EMPLOYEES AND THEIR DEPENDENTS NEED AND

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DESERVE. AS WITH THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM, NEW FEDERAL EMPLOYEES WILL NOT VEST FOR FIVE YEARS.

FEDERAL EMPLOYEES HEALTH BENEFITS

NOW I WOULD LIKE TO TURN TO THE FEDERAL EMPLOYEES HEALTH BENEFITS (FEHB) PROGRAM, WHERE WE ARE ALSO PROPOSING A MAJOR LEGISLATIVE REFORM. THE FEHB PROGRAM HAS UNDERGONE SEVERE STRAINS IN THE LAST SEVERAL YEARS, AND THESE STRAINS ARE DIRECTLY ATTRIBUTABLE TO FUNDAMENTAL FLAWS IN THE CURRENT DESIGN OF THE PROGRAM. WHILE THE PROGRAM HAS HAD MANY VERY GOOD FEATURES, SUCH AS THE WIDE CHOICE OF PLANS AVAILABLE, IT HAS BEEN DIFFICULT TO CONTROL COSTS, SINCE THE GOVERNMENT'S CONTRIBUTIONS HAVE BEEN CONTROLLED BY THE COST OF ONLY SIX OF THE SOME 130 PLANS IN THE PROGRAM.

TO DEAL WITH THIS PROBLEM, WE ARE PROPOSING A SYSTEM THAT WILL ENHANCE INCENTIVES FOR CARRIERS, HEALTH CARE PROVIDERS AND ENROLLEES TO CONTROL HEALTH CARE COSTS. WE ARE PROPOSING WHAT IS CALLED A "VOUCHER" SYSTEM. THE VOUCHER CONCEPT IS ONE THE ADMINISTRATION IS PURSUING IN SEVERAL AREAS, NAMELY MEDICARE, EDUCATION AND HOUSING ASSISTANCE, AND UNEMPLOYMENT COMPENSATION, AND WE BELIEVE THIS APPROACH CAN MAKE A VALUABLE CONTRIBUTION TO THE FEHB PROGRAM TOO.

UNDER THIS SYSTEM, OPM WOULD NO LONGER NEGOTIATE DETAILED CONTRACTS WITH CARRIERS. INSTEAD, ANY CARRIER THAT IS PREPARED TO MEET CERTAIN MINIMAL REQUIREMENTS WOULD BE ADMITTED TO THE PROGRAM, AND WOULD BE FREE TO OFFER ANY NUMBER OF PLANS IT WISHED. ALL PLANS WOULD BE REQUIRED TO OFFER COMPREHENSIVE CATASTROPHIC COVERAGE, BUT WOULD OTHERWISE BE FREE TO DESIGN

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THEIR BENEFIT PACKAGES IN WHATEVER WAY THEY THINK WOULD ATTRACT THE MOST ENROLLEES. ENROLLEES WOULD RECEIVE INFORMATION TO HELP THEM IN SELECTING THE PLAN BEST SUITED TO THEIR NEEDS.

THE GOVERNMENT CONTRIBUTION WOULD NO LONGER BE CAPPED AT THE CURRENT 75 PERCENT OF A PLAN'S PREMIUMS SO ENROLLEES WOULD NO LONGER BE PENALIZED FOR ENROLLING IN A LOW-COST PLAN. ENROLLEES WOULD EVEN BE ABLE TO RECEIVE A REBATE IF THE PREMIUM FOR THE PLAN THEY CHOOSE IS LESS THAN THE GOVERNMENT CONTRIBUTION. THE GOVERNMENT CONTRIBUTION WOULD NO LONGER BE DETERMINED BY THE COSTS OF PARTICULAR PLANS, BUT WOULD INSTEAD BE BASED ON AVERAGE GOVERNMENT CONTRIBUTIONS IN 1983 FOR SELF ONLY AND SELF AND FAMILY COVERAGE, AND WOULD BE ADJUSTED IN FUTURE YEARS BY A GENERAL PRICE INDEX.

FINALLY, THE POSTAL SERVICE AND THE DISTRICT OF COLUMBIA GOVERNMENT WOULD BE REQUIRED TO PAY THE GOVERNMENT CONTRIBUTION FOR THEIR ANNUITANTS, BECAUSE FEDERAL SUBSIDIES TO THESE INDEPENDENT ENTITIES ARE NOT APPROPRIATE.

WE BELIEVE THESE CHANGES WILL SUBSTANTIALLY IMPROVE THE FEHB PROGRAM. THEY WILL OFFER EMPLOYEES A WIDER RANGE OF BENEFIT PACKAGES, AND THE CURRENT PENALTY FOR CHOOSING LOW-COST PLANS WILL BE REMOVED. AT THE SAME TIME, ALL ENROLLEES WOULD BE PROTECTED AGAINST CATASTROPHIC MEDICAL EXPENSE. THERE WILL BE STRONGER COMPETITION IN THE PROGRAM, AND ENHANCE INCENTIVES FOR CARRIERS TO CONTROL COSTS. THE USE OF AN INDEXED GOVERNMENT CONTRIBUTION WILL CONTROL THE GOVERNMENT'S COSTS AND RESULT IN SUBSTANTIAL SAVINGS IN GOVERNMENT OUTLAYS IN FUTURE YEARS, WHILE STILL ENSURING ADEQUATE HEALTH CARE FOR FEDERAL EMPLOYEES AND ANNUITANTS.

THANK YOU. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THE SUBCOMMITTEE MAY HAVE.